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Addendum

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Chapter II

PATHS TO DEVELOPMENT: PERFORMANCE, PROBLEMS AND REFORMS OF PUBLIC ENTERPRISES

(Agenda item 4)

30. For its consideration of this item, Sessional Committee I had before it the following documentation:

"The Trade and Development Report, 1992, including the Overview: Report by the UNCTAD secretariat" (UNCTAD/TDR/12).

31. The Officer-in-Charge of Resources for Development Programmes made an introductory statement on this item in which he referred to the issues raised in part III, chapter 2 of the Trade and Development Report, 1992, which dealt with reforming public enterprises.

32. The representative of Brazil stated that the reform of public enterprises required close attention on the part of developing countries, in view of their structural reform efforts. In most countries, reform was not simply a question of adjustment but rather a real change in the previously adopted development model. It was part of a process that involved the redefinition of the role of the State. In consequence, parallel to the privatization process, it was of utmost importance to discuss areas where public enterprises should be preserved or might need to be established. Considerations related to the operational situation of enterprises, although relevant, were not central issues: a public enterprise might be profitable in a sector where the State was no longer considered necessary, and vice versa. Factors such as the existence of natural monopolies or locational diseconomies were relevant. Sectoral examination of the effects of privatization and deregulation in different countries was also relevant as were management problems. With regard to the improvement of their management, the objectives of public enterprises should be defined including non-economic aims, even under tight budget constraints. A tight budget did not preclude fulfilment of non-economic objectives if the costs had been clearly defined and were strictly reimbursed. In this context, the "contract" system adopted by Brazil and other countries merited further examination. A long-term perspective had to be taken in regard to the reform of public enterprises, certainly longer than that envisaged in most adjustment programmes.

33. The representative of Japan observed that, pursuant to the Cartagena Commitment, an ad hoc Working Group on comparative experiences on

privatization had been established by the Trade and Development Board at the second part of its thirty-eighth session. This initiative was timely as many countries were actively carrying out programmes of privatization as part of their structural adjustment. The work of the ad hoc group would also be of significance to developing countries because of the important role of public enterprises in their economies. The deliberations on this agenda item during the current session could be a forerunner of productive work in the ad hoc Working Group. The analysis in the Trade and Development Report, 1992 offered a good basis for discussion. Regarding the chapter on public enterprises in the Report, notwithstanding the importance of learning from the experience of other countries, the diversity of country situations should always be taken into account. Moreover, emphasizing the importance of long-term corporate planning for both private and public enterprises, as the Report did, had a great deal of validity in view of the costs and time in "learning-by-doing". Japan was prepared to share its experience on privatization with others in the ad hoc Working Group. Privatization of the National Railway in Japan was one example of experience which could be of considerable interest to others and, with this in mind, copies of an explanatory note on the subject were being made available to interested delegations.

34. The representative of Romania noted that the best solution to unsatisfactory performance of public enterprises was usually privatization. The recommendations of the Report on the approach to reforming such enterprises would, nevertheless, be useful for countries undertaking large-scale privatization, when many enterprises remained under public ownership for quite some time. Romania had transformed former State enterprises in strategic sectors into autonomous public corporations having full managerial and financial autonomy with costs covered entirely from the proceeds of sales with the exception only of activities in the public interest. All other State enterprises had been transformed into commercial companies: either joint-stock or limited liability companies. They had then been restructured and split up into several smaller firms which had helped to increase competition, as did the liberalization of prices, external trade and the rules governing foreign investment. Moreover, legislation had been passed to assure fair competition. According to the privatization law, 30 per cent of the equity capital of commercial companies was being privatized through the free distribution of ownership certificates to Romanian citizens who had

reached 18 years of age on 31 December 1990. The remainder of the equity would be sold to interested buyers, including foreigners. The holders can use the certificates to acquire shares in the companies.

35. The spokesman for the Asian Group (Pakistan) stressed the importance of public enterprises in developing countries, especially in sectors where considerable investment and organization were required; even in developed countries their role was important. In the manufacturing sector, public enterprises increased indigenous productivity, generated employment, created downstream industry and provided government with revenues in the form of taxes and profits. While price escalation and food scarcity had prompted the establishment of public consumer-goods industries, deregularization subjected those industries to competition with the private sector, with their role being taken over by the latter. In public enterprises minimum wages could be assured and projects where there was a risk of loss or less profitability could be taken up. Government railway and transport systems, for instance, might have to run on routes where they incurred losses. Profitability was thus not the objective; rather it was public service. While it might be easy to turn a loss-making public enterprise into a profitable one by increasing prices, this was not the objective of governments. Problems of funds and running capital in the public sector had prompted many countries to turn their public enterprises into self-supporting corporations headed by professional managers, instead of government officials. Owing to the complexity of the issues involved in reforming public enterprises and in the absence of a tailor-made reform programme, Governments should be allowed to introduce changes as they deem necessary. As stated by the chairman of the Group of 77, public enterprises in developing countries had played an important role with regard to investment. Certain enterprises had suffered from bad management owing to the lack of effective accountability; in such cases, decisions on operations should be left to managers, with government monitoring the output. It was important to maintain a close relationship between the performance of the private and public sectors.

36. The representative of China commended the Trade and Development Report, 1992 for its analysis of public enterprise reform issues and review of public enterprise activities in both developed and developing countries. The concrete examples had facilitated an objective comparison between the achievements of public and private enterprises. The Report had not neglected

the problems while pointing out ways and means to reform these enterprises. Public enterprises were very important in many developed and developing countries, whatever the political regime and philosophy. Improvement of their efficiency remained a major objective. However, there was no single approach universally applicable for their reform. Different countries might adopt different options, according to their own situation. She then briefly reviewed the Chinese public enterprises and the progress of their reform.

37. While encouraging the development of other forms of economic entities, publicly-owned enterprises were the backbone of the Chinese economy. Despite their past contribution, these enterprises faced the need to reform their management systems. The Law on Enterprises adopted on 13 April 1988 had played a certain role in promoting autonomy in operational management and development, as well as self-responsibility for profits and losses. Yet as the old management system had not been fundamentally changed, the State-owned enterprises had not genuinely become independent manufacturers and managers, nor could they participate effectively in the competition in domestic and international markets. So as to promote the transformation of management mechanisms and to stimulate market vitality, the State Council had adopted the "Regulations on the Transformation of Management Mechanisms of State-owned Enterprises" ("Regulation") on 30 June 1992. Enactment of these Regulations - covering general principles, management rights, responsibility for profits and losses, conversion and liquidation, relationships between enterprises and the Government and legal obligations - was an important event in the economic reform of enterprises in China and the Regulations would play an important role in revitalizing State-owned enterprises.

38. The representative of Chile welcomed the chapter on public-sector reform in the Report as a valuable contribution to the discussion. Chile had undertaken far-reaching reforms of its public enterprises; in most cases they had been privatized. The experience of most countries had shown that internal reform of public enterprises was generally insufficient. The move to a free-market economy implied a strengthening of the private sector accompanied by a decision to restrict direct economic activity of the State to those areas either of no interest to the private sector or related to activities with strictly social objectives. Decisions on ownership had to be taken pragmatically, however. Efficiency was not the only criterion in deciding whether to keep an enterprise in the public sector or to privatize it; such

decisions had to be taken with a view to reaching the higher aims of the State, which included social objectives. He added that in assessing the options for reform, it was important to recognize that the effects of alternative solutions differed depending on the sector. The implications for the development of each sector as well as private investment were as important as increases in enterprise efficiency.

39. The representative of the Islamic Republic of Iran said that the Report contained useful points on the strategic role of public enterprises in the economies of both developing and developed countries. The Report had also cautioned against uncalculated privatization. Both public and private enterprises could serve as a means to promote and develop the national economy. The expansion of such enterprises was not in itself an objective, however. The supremacy of one sector over another was rooted in the political structure of a country and reflected its historical and cultural background as well as development trends. The establishment of a market system did not mean the elimination of the guiding and supervisory role of government. Lack of initiative, sluggish decision-making, undue expansion of bureaucracy, disregard for the optimal allocation of resources, increases in public expenses and budget deficits were among the deficiencies attributed to the operation of public enterprises. However, an important question was whether private enterprises in a given country were prepared or able to assume the role and responsibilities incumbent on public enterprises and whether, in the absence of a desirable private sector, public enterprises played a role aimed at meeting specific economic objectives of the society. The private sector in the Islamic Republic of Iran had resumed its activites once the wartime economy had turned towards a rebuilding effort. The Stock Exchange had been reactivated and shareholding in the private sector had leapt from 8 million in 1990 to 48 million in 1991, a trend that was continuing. In internal trade, the Government had largely abandoned price controls, quotas, rationing and centralization policies. Likewise, subsidies were gradually being eliminated (except for vulnerable groups of society), and markets were becoming more competitive, thus providing grounds for optimum allocation of factors of production and reduction of red tape. In each country the private sector had distinct features and significance. The sector did not have a single unified mechanism for decision-making and operation and the basis for participation could differ.

40. The representative of the Russian Federation said that the search for the optimal balance between the public and private sectors was a key aim of Russian reform programmes. Large-scale privatization was central to the reform process with the main targets of the programme expected to be achieved in three to four years. The necessary legal base and the State programme for privatization of public enterprises, including municipal ones, had been adopted in 1992. The population, through the distribution of privatization cheques, would be involved in the process and hence would constitute the social basis of the market economy, making the reform irreversible. There were two main types of massive privatization - that of small public enterprises engaged in the commerce, service and construction sectors and that of large industrial public enterprises. Thirty per cent of productive assets were expected to be privatized by 1993, reaching 50 and 60 per cent by 1994 and 1995, respectively. However, the public sector would remain vital and would compete with the private sector. The section on public enterprises in the Report had practical interest for the reform of the public sector in Russia. The secretariat should be encouraged to continue its work on this topic. Discussions on comparative experiences with privatization should prove fruitful in the ad hoc Working Group that had been established to deal with this subject.

41. The representative of Colombia said that the chapter on public enterprises in the Report was particularly pertinent at a time where most Latin American countries, including Colombia, were implementing privatization programmes. In a world where consensus on the benefits of the market-economy was so widespread, efficiency at the enterprise level was frequently confused with economic results, while the well-being of the economy as a whole may hide social deterioration. There was no evidence that public enterprises were inherently inefficient and their reform was not synonymous with privatization. The decision to privatize or to maintain and restructure public enterprises had to be taken with full recognition of the objectives, which could be ideological, strategic, social, macroeconomic, etc. Specific reforms should be taken with attainment of objectives in mind. In Colombia, privatization had started some years ago with the sale of Government stakes in mixed enterprises. In some cases, such as railways and ports, privatization had been chosen because the State had identified difficulties in carrying out administration and exercising control. Certain services had also been

privatized. Some banks were being re-privatized after State intervention to counteract speculation and mismanagement. In the telecommunications sector, private telephone companies were allowed to compete with public enterprises; currently there was a debate under way over the advantages and disadvantages of permitting the establishment of private television chains. The ad hoc Working Group on Privatization could help in dealing with all such questions.

42. The representative of Mexico said that in his country the problem of public enterprises representing a heavy burden on government finances was to be solved by liquidation or privatization. The economic crisis of the 1980s had led the Government to define the functions and priorities of public enterprises more precisely. In the past, the State had assumed too many activities and priorities often got side-tracked. The capacity, both political and financial, to attain goals was strained. Moreover, the transformation of Mexican society had substantially changed the tasks facing the State. Urgent problems included a social and economic lag in rural areas, indigenous communities and slum belts around big cities. Expansion of State participation in almost all areas of social life had been inevitable during a period of reconstruction and industrial start-up, but it had lost its effectiveness and popular support. Privatization was not only a question of making enterprises operate more efficiently, but had a broader political dimension: to allow public ownership only in areas of strategic national interest. Accordingly, the State was now concentrating on such basics as social infrastructure, promoting regional balance and satisfying the basic needs of the population. Mexico had privatized more than 900 enterprises since 1982 with positive effects on industrial modernization and public finances. However, countries with different characteristics and priorities might prefer other options. Those opting to maintain public ownership might give strong consideration to promoting efficiency through medium- and long-term reform projects.

43. The representative of Austria welcomed the fact that an entire chapter of the Trade and Development Report, 1992 had been dedicated to the highly controversial issue of reforming public enterprises. However, in order to place the problem in the proper perspective, he believed that the Report ought to have contained at least a brief description of what was actually going on in most countries of the world. It could not be taken for granted that so many Governments had embarked on vast privatization programmes without

convincing reasons. While UNCTAD VIII had decided to entrust an ad hoc working group with the question of privatization, the Report had dealt with the subject only en passant. Although there were limits to the speed and scale of privatization, no one should underestimate its potential; experience had shown that privatization was also possible under very unfavourable conditions. Some evaluation of the effects of privatization would have been useful. The World Bank had come to the conclusion that, in the great majority of cases, productivity and investment had been increased, and a higher degree of diversification had been achieved through privatization. Normally the decision to privatize would not be based on ideology; it would be an outcome of situations where economic policy-makers had no alternative for resolving intractable problems. Certainly, privatization was not always considered desirable but the move in this direction had been set in motion when the burden on society became disproportionate to the benefits derived from the State-run enterprise. While the Report had given rather too much space to the reasons leading to the establishment of public enterprises, their characteristics and performance record, it did nevertheless quite convincingly capture the whole complexity of the issue of restructuring. The perhaps unintended message of the Report was that reform was a most delicate matter which would succeed only if a great number of prerequisites were met. It might not be surprising if Governments after studying the analysis reached the conclusion that privatization offered better chances of success than reform.

44. The representative of India emphasized that while there was no general rule for reforming public enterprises, granting them functional autonomy and establishing specific and quantifiable performance criteria was a necessary prerequisite to restructuring them for greater efficiency. Establishing competitive market conditions was likewise essential for improving their performance. Technological change had opened possibilities which could lead to the creation of markets even in cases which once would have been considered natural monopolies. In general, administrative controls on prices and distribution should be avoided and open-ended subsidies phased out. As the restructuring exercise would affect employment conditions, it was important to establish adequate social safety systems for retraining the work force. To this end, multilateral financial agencies and United Nations bodies could help with financial and technical support. Reform of public enterprises did not

imply the withdrawal of the State from all economic sectors. Government involvement would continue to be required for education, research and development and advances in technology, for example.

45. The spokeswoman for the European Economic Community (United Kingdom) said that, by setting out the necessary and productive contributions of public sectors and the diversity of historical experience, the Report had provided a helpful perspective on the issues and a valuable counterbalance to dogmatic popular views. Government enterprises had an important part to play in successful development. Their productive contribution could usefully be studied by developing countries. Public enterprises could benefit an economy in a variety of ways, such as in areas where the market by itself could not achieve particular socio-economic objectives, and in industrial innovation. The "knock-on" effect on the rest of the economy of the public sector's procurement policies could also help support growth in ancillary industries. A thriving public sector played a major role in the development of an economy and the Report noted that many public enterprises operated at a profit, particularly in developing countries. Nevertheless, they also had less advantageous features. In particular, the idea of having State monopolies protected by the Government from domestic competition should be approached cautiously; monopolies were hard to reconcile with attracting foreign direct investment, an important factor in stimulating economic growth. Moreover, nationalized industries were vulnerable to political and bureaucratic intervention as well as public financing constraints. Overloading public enterprises by requiring them to fulfil too many social and commercial objectives could lead to none of the objectives being achieved satisfactorily. Public enterprises could also affect the market opportunities faced by private sector competitors, for example, by crowding them out of access to finance. The Report could have given more attention to the last issue. To enable public enterprises to act more effectively to promote growth, Governments would have to set strategic objectives and define performance indicators.

46. The private sector was the main means of generating wealth in the economy. Governments should adopt policies that promoted private enterprise by encouraging competition and free markets, by cutting back on excessive regulation and by creating a climate of confidence to attract both foreign and domestic investment. Privatization of public industries and the creation of private sector competition were the key means of ensuring that goods and

services were available at the lowest economic cost. The widespread use of privatization within the structural adjustment programmes was a welcome step. Local participation should be encouraged to help extend ownership of wealth more widely in the economy, giving citizens a direct stake in the success of an industry through share ownership. Considerable foreign direct investment had been attracted thus enabling a transfer of technology and business skills. However, adequate regulatory and supervisory mechanism were important to stop uncompetitive practices. Privatization was not the only option and should not be pursued in isolation from development of social-economic policies and legal conditions. Less far-reaching reforms, such as partial privatization of peripheral services while maintaining central services under the State, could be beneficial to the economy. Public sector privatization did not mean abandoning public services. The State could create favourable conditions for private enterprise, particularly by providing the necessary infrastructure. Given the difficulties inherent in taking the enormous step towards privatization, some countries might wish to take a gradual approach. The ad hoc group could, it was hoped, explore privatization in terms of the far-reaching practical advantages it held for countries contemplating such programmes.

47. The representative of Poland stated that reform of public enterprises had mainly been taking the form of privatization in Poland because companies in the private sector were more productive and efficient. The primary objective of ownership transformation in Poland involved a systemic changeover: the moulding of an economy dominated by the private sector so as to improve economic efficiency. A dual approach was being taken: transformation of the ownership form of existing State enterprises, and creation of new private economic entities. To this end, the activities carried out since 1990 had encompassed: reprivatization, privatization, changes in management systems of public property, and the reconstruction and development of financial and organizational infrastructure. A total of 1,669 companies - 21 per cent of all State-owned enterprises - had been privatized so far. An intense process of privatizing small industrial and service companies was also under way. Thus the participation of the private sector in all branches of the economy was expanding rapidly.

48. The representative of Indonesia stated that the subject of public enterprises was most pertinent in relation to efforts to formulate macroeconomic policies conducive to growth and development. State-owned enterprises were essential in areas where the private sector was unwilling to engage itself or was constrained by financial limitations, unattractive investment prospects, etc. There were also special objectives associated with State-owned enterprises. However, private sector involvement would need to increase in line with the pace of economic development. The role and performance of State-owned enterprises would need to be evaluated so as to ensure that they made an adequate contribution to economic development. Simultaneously, Governments could create a favourable environment for greater participation of the private sector as well as for restructuring State-owned enterprises. A more stable and competitive macroeconomic environment would greatly help in identifying candidates for privatization. In summary, there was a need for political will on the part of Governments. Privatization was not simply a question of transferring ownership but rather one of how best to improve management capabilities and efficiency.